

ADGM's Tax Efficient Platform for Investing  
into the Kingdom of Saudi Arabia

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## Introduction

Certain Gulf Cooperation Council (GCC) Member States tax foreign ownership differently to GCC or national ownership. Broadly, companies owned by foreign shareholders are either subject to tax (instead of being exempt) or subject to a higher tax rate.

This different treatment is based on the GCC Unified Economic Agreement (GCC Agreement) that was entered into by Bahrain, Kuwait, KSA, Oman, Qatar and the UAE on 31 December 2001.

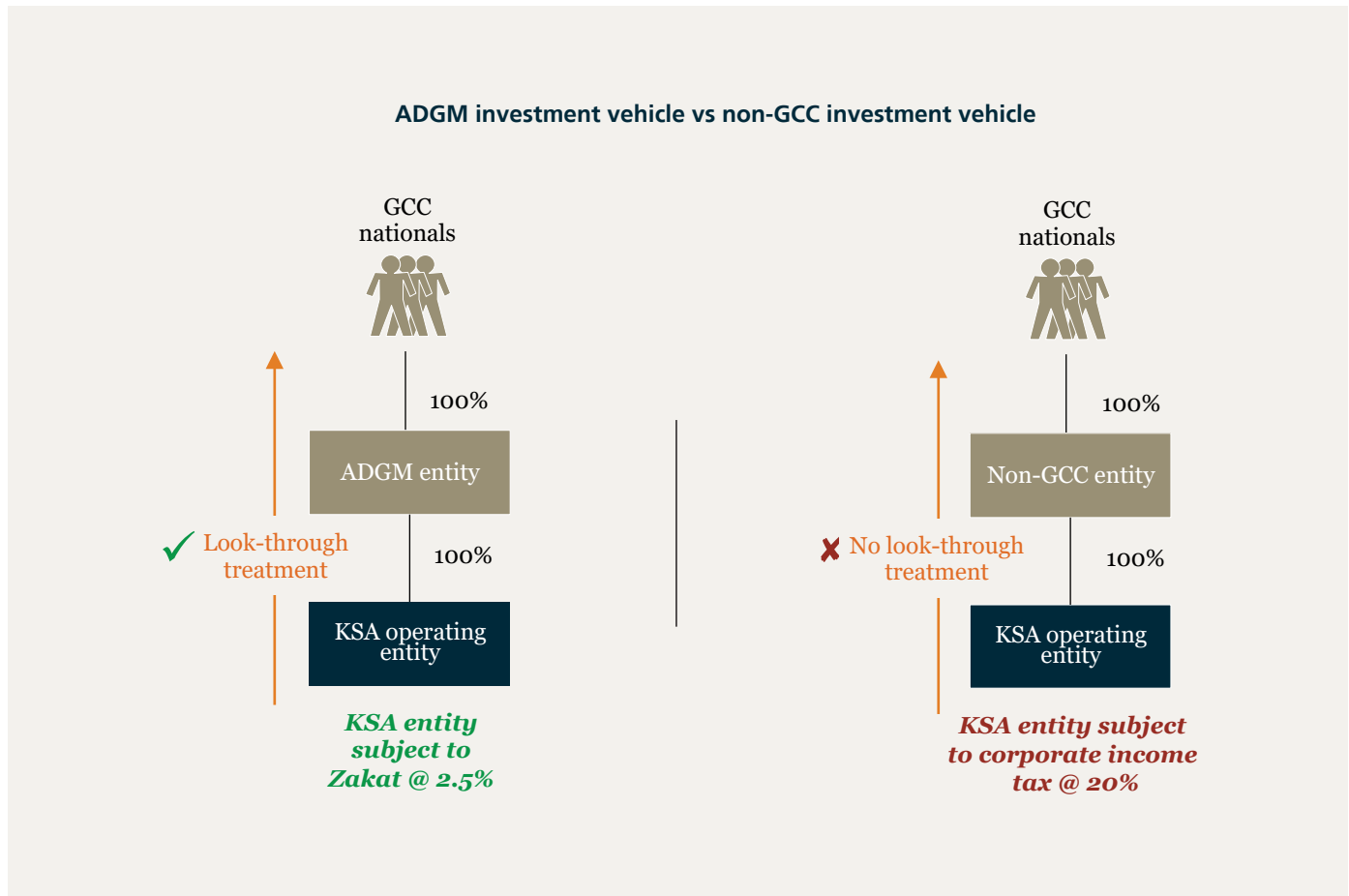
Under the GCC Agreement, GCC member states are required to afford other GCC nationals and GCC legal entities the same taxation treatment as national individuals and companies.

As certain GCC countries do not tax their own nationals and exempt or apply a more favourable tax treatment to local companies wholly owned by national shareholders, other GCC incorporated entities owned by GCC nationals benefit from the same exemptions or are subject to the same Zakat / tax treatment.

## Taxation of KSA companies

The Kingdom of Saudi Arabia (KSA) operates a two tier "tax" system which taxes KSA companies based on the nationality and residence of its ultimate shareholders.

- KSA companies wholly owned by GCC national shareholders are subject to Zakat at 2.5% on their adjusted net profits or adjusted net asset value (Zakat base).
- KSA companies wholly owned by non-GCC national shareholders are subject to corporate income tax at 20% on net profits.





- A KSA company that has both KSA/GCC and non-KSA/GCC shareholders is subject to corporate income and Zakat on a proportionate basis.

In practice, the KSA tax authorities (GAZT) will look through the chain

of ownership of a KSA company to the ultimate owners to determine whether the KSA company is subject to Zakat, corporate income tax or both. Look-through treatment is, however, generally not applied to a non-GCC entity in the ownership chain.

As a result, using a non-GCC entity to invest into KSA may result in all of the profits of the KSA company being subject to 20% corporate income tax, irrespective of the profile of the ultimate investors. Essentially, using a non-GCC vehicle to invest into KSA could “block” or “dilute” the GCC nationality of the ultimate GCC shareholders.

### Key takeaways

KSA companies owned by GCC national shareholders, directly or indirectly via GCC incorporated entities, are subject to Zakat at 2.5%. KSA companies owned by non-GCC shareholders or via non-GCC incorporated entities, on the other hand, are subject to 20% corporate income tax.

ADGM registered companies should be considered UAE (GCC) incorporated

entities. The KSA tax authorities should therefore look through an ADGM entity for purposes of determining whether a KSA company is subject to Zakat (2.5%) or corporate income tax (20%) based on its ultimate (GCC vs. non-GCC) ownership.

This, together with a world-class infrastructure and legal/regulatory framework, makes ADGM a highly attractive platform for investment into

KSA by GCC investors or a mix of GCC and “foreign” investors.

The KSA-UAE double tax treaty entered into force on 1 April 2019. The treaty will apply from 1 January 2020 and is the first bilateral tax treaty between GCC Member States. The treaty may further improve the tax efficiency of ADGM as a platform for KSA investments, with a possible exemption from withholding tax on interest and service fees, and a potential reduction of withholding tax on royalties to 10%.

## Using ADGM as a platform for investing into KSA

Whilst ADGM has its own commercial and civil legal framework, entities incorporated in ADGM are companies incorporated under the laws of the UAE and should therefore be considered as “GCC legal citizens” under the GCC Agreement.

As such, the GAZT should look through an ADGM entity in the ownership structure of a KSA company for determining whether Zakat and/or corporate income tax should apply to the profits of the KSA company.

Where the ADGM entity has both GCC and non-GCC shareholders, only the portion of the underlying KSA profits attributable to the non-GCC shareholders should be subject to 20% corporate income tax. The remaining profits of the KSA company that are attributable to the GCC shareholders in the ADGM

entity should be subject to Zakat at 2.5%.

Investing into KSA through an ADGM entity may therefore result in a more favourable tax outcome in KSA as compared to using a non-GCC investment/holding entity (please refer to the illustrative example on page 5).

### New regulations

In February 2018, the KSA Ministry of Finance issued a Ministerial Resolution that may impact the manner in which the Zakat/tax profile of KSA companies is determined.

Previously, there was no limitation in respect of the number of intermediary entities and the KSA tax authorities could look all the

way up to the ultimate beneficial owners to determine the tax profile of the underlying KSA entity.

Under the new regulations, the Zakat/tax profile of a KSA company should be assessed based on its direct and indirect ownership, where “indirect ownership” is limited to two levels above the KSA entity.

The amendment appears to say that a KSA company owned indirectly through at least two intermediate GCC (non-KSA) companies should be subject to Zakat at 2.5% only.

The new indirect ownership concept is untested and represents a change to existing KSA law and practice. The application by the GAZT should therefore be closely monitored and where appropriate confirmed through an advance tax ruling.



## Non-resident taxation in KSA

### KSA taxation on cross border payments

There is currently no difference in treatment between GCC (non-KSA resident) and non-GCC entities and individuals with regards to the withholding taxation of cross-border payments and the taxation of capital gains on the disposal of KSA shares and other assets.

The applicable withholding tax vary depending on the type of income as follows:

Type of income	Rate
<b>Dividends</b>	<b>5%</b>
<b>Interest and loan fees</b>	<b>5%</b>
<b>Royalties</b>	<b>15%</b>
<b>Management fees</b>	<b>20%</b>
<b>Rent, technical and consulting services, international telecommunication services, and income from air tickets, air and maritime freight, and insurance/reinsurance premiums</b>	<b>5%</b>
<b>Payments for technical, consulting and international telecommunication services made to a head office or to a related company</b>	<b>15%</b>
<b>Other services (e.g. training, recruitment, bookkeeping, marketing) where part of the services are carried out in KSA</b>	<b>15%</b>

### KSA taxation on the direct disposal of KSA companies

Non-KSA resident shareholders (whether resident in a GCC or non-GCC country) are subject to 20% capital gains taxation on the disposal of shares in a KSA company.

Gains from the disposal of securities listed on the Saudi Stock Exchange (Tadawul) or KSA shares listed on a foreign stock exchange should not be subject to taxation in KSA.

## Double tax treaty (DTT) network

KSA has in-force double tax treaties with 49 countries that may, among other benefits, reduce or eliminate KSA withholding taxes and exempt capital gains on the sale of shares and other KSA assets from KSA taxation.

The KSA double tax treaty entered into force on 1 April 2019. The treaty will apply from 1 January 2020 and is the first bilateral tax treaty between GCC member states. The treaty may further improve the tax efficiency of ADGM as a platform for KSA investments, with a possible exemption from withholding tax on interest and service fees, and a potential reduction of withholding tax on royalties to 10%.

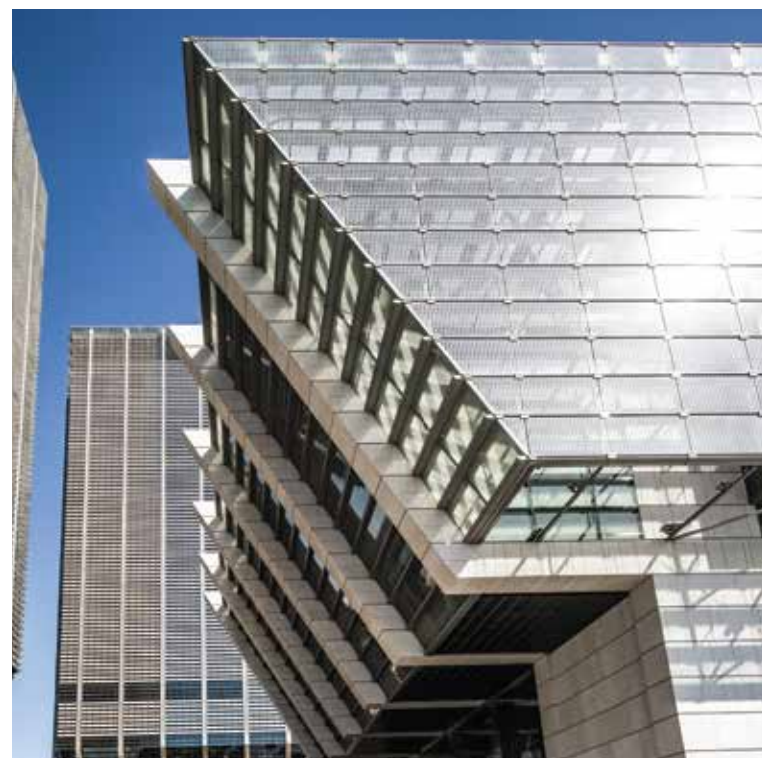
KSA is a G20 member country and therefore committed to the implementation of the OECD Base Erosion and Projects Shifting (BEPS) project, and the UAE joined the OECD inclusive framework in 2018. The UAE also recently ratified the OECD Multilateral Instrument (MLI) to implement the double tax treaty related BEPS minimum standards, and KSA signed the MLI in 2018. This means that any ADGM structure should have adequate substance and be supported by principal non-tax reasons in order to ensure treaty benefits are available.

### Transfer pricing

On 15 February 2019, the General Authority of GAZT released the final version of Transfer Pricing Bylaws ("TP Bylaws") in KSA. The TP By laws are largely consistent with the OECD Transfer Pricing Guidelines.

The TP Bylaws are applicable to all taxpayers, including Permanent Establishments ("PEs"). For the implementation of Arm's Length Principle, all entities (including PEs) of a multinational group should be treated as separate entities that operate independently.

All intercompany transactions between a PE and other entities must be in accordance with the Arm's Length Principle.

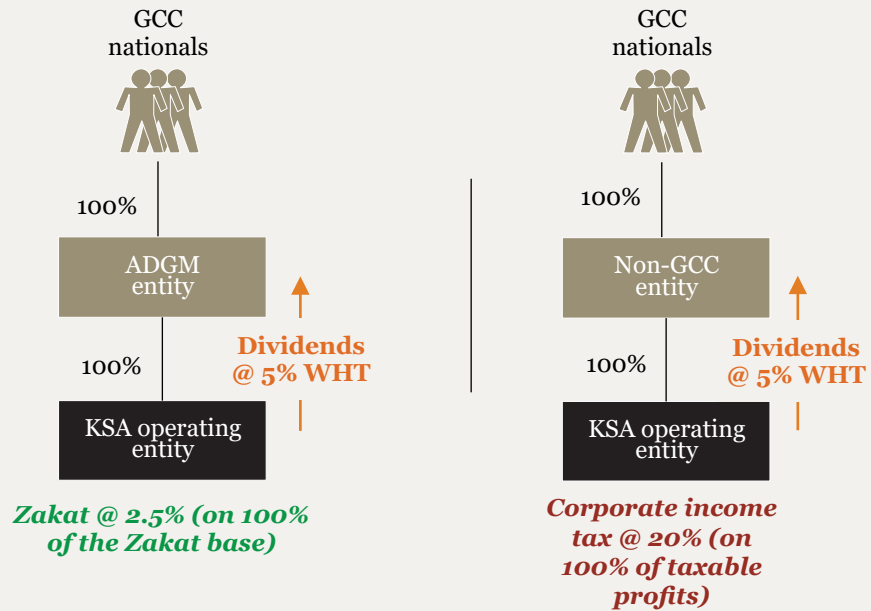




## Taxation of KSA operating companies

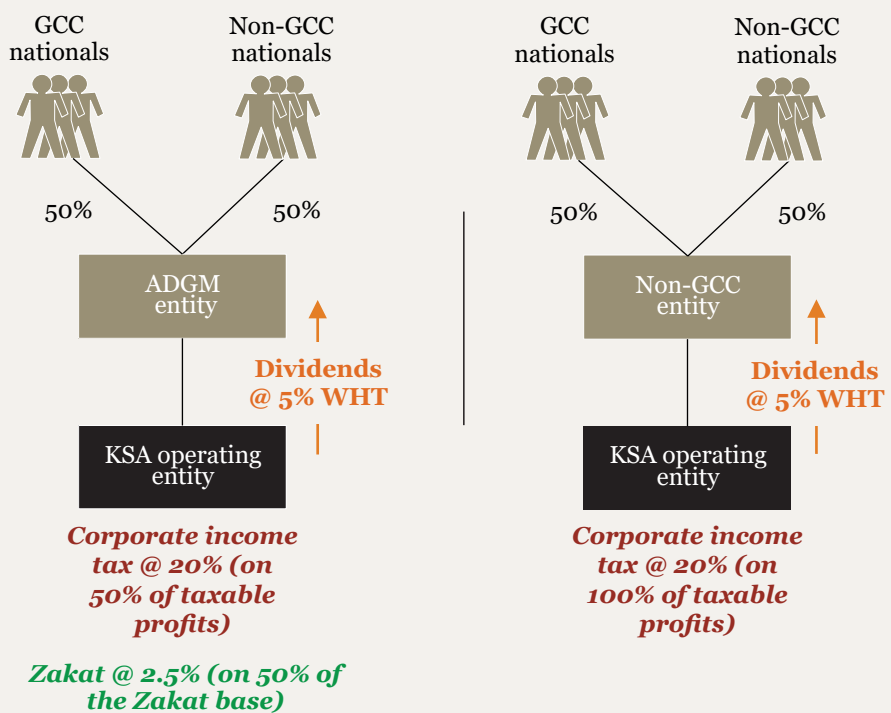
### Example 1

This example illustrates the potential difference in ongoing taxation and the taxation of profits being repatriated as dividends of a KSA company held by an ADGM entity that is wholly owned by GCC investors (left) versus by a non-GCC investment vehicle (right).



### Example 2

This example illustrates the potential difference in ongoing taxation and the taxation of profits being repatriated as dividends of a KSA company held by an ADGM entity that is 50% owned by GCC investors (left) versus by a non-GCC investment vehicle (right).





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